ICMA
International Capital Market Association

The Bank of England's Corporate Bond Purchase Scheme
Meeting with the ICMA Secondary Market Practices Committee
November 2016

On 10 November 2016, the Bank of England joined a meeting of ICMA's SMPC to discuss its Corporate Bond Purchase Scheme (CBPS), which was launched in September 2016.

Key discussion points arising from that meeting are summarized below:

Pace of purchases: As of 3 November 2016, the Bank had purchased £2.4 billion of eligible corporate bonds, which was ahead of schedule with respect to a target of £10 billion in 18 months. The Bank noted that the size of auctions, which were designed to be able to respond to a potential large supply of bonds in the initial stages, had not fallen as quickly as some might have expected. it was suggested by some participants that <u>at the current run-rate the CBPS could be completed as early as March 2017</u>.

Impact on spreads: It was noted that, while the CBPS had originally tightened spreads (following the announcement), spreads had subsequently widened and had not been under any pressure since the purchases began. Nobody seemed to think that the purchases were causing any market dislocations or stresses. The point was also made that there had not been any significant impact on tightening non-eligible spreads.

Risk of cliff-effect: Some market participants raised a concern about a possible "cliff-edge" effect once the Scheme finished, and a subsequent sharp sell-off. The Bank felt that this depended on whether the impact was a flow impact or a stock impact.

Primary market impacts: In terms of primary issuance, it was noted that there had been a marked increase in new sterling deals following the announcement, but this had tapered off since.

Secondary market liquidity: The Bank was interested to know whether the Scheme had impacted secondary market liquidity. Some comments suggested that the Scheme had possibly helped liquidity, with dealers feeling more confident showing bids for eligible bonds. However, another view was that dealers could not be certain of being able to sell eligible bonds to the Bank as the auctions tended to be over-offered, and so had little impact on dealers' decisions. One inter-dealer broker (IDB) commented that inter-dealer flow had certainly slowed since the start of the Scheme. A further comment was that dealers now avoided shorting smaller eligible issues, but for larger issues it was business as usual.

Repo market: One dealer commented that there had been no impact on the sterling repo market, and that borrowing and financing rates were unchanged.

Eligibility issues: There was a lengthy discussion about how the Bank updated and communicated the eligibility list. The concept of bonds issued by companies "that make a material contribution to economic activity in the UK" had caused confusion, and it was difficult to predict what was eligible or not as there seemed to be no consistent criteria. The Bank explained that eligibility is a risk management decision and there is legal due diligence on individual issues, although it could not comment on why some credits (eg Morisons and GKN) are not in scope.

Bonds with calls: The Bank was asked why they excluded bonds with 3 month calls, particularly as this excluded a significant amount of potentially eligible bonds. The Bank suggested that the Scheme was designed as a long-term investment strategy and not to manage optionality. However, they suggested that this could be a consideration at a future date.

Exit strategy: The Bank was asked whether they had an exit strategy for the Scheme. They stated that this would be a policy decision of the MPC.

Transparency and comparisons with the CSPP: The Bank asked about the transparency and methodology of its Scheme compared with the ECB's CSPP. Most felt that the auction system worked well, rather than bilateral purchases. It was felt that the pre-trade transparency provided by an auction process allowed the Scheme to reach end-investors. However, in terms of post-trade transparency, market participants would appreciate not only an ISIN list of purchases, but also the sizes purchased. It was noted that this was how the Bank operated its 2009-10 corporate bond purchase scheme; however, the Bank explained that the 2009-10 programme had a very different objective (essentially to be "market-maker of the last resort"), whereas the CBPS was effectively an investment strategy and so they could not provide too much post-trade transparency.

Auction window timing: The Bank was interested to know whether the 45 minute auction window was appropriate. Market participants felt that now dealers were comfortable with the process the window should be much shorter. This would help reduce the uncertainty over auction periods, and so improve liquidity.

Follow-up with the Bank of England

ICMA, through its SMPC, will continue to remain in close contact with Bank of England in order to facilitate ongoing communication between the market and the UK central bank on the implementation and impacts of the CBPS.

Prepared by Andy Hill, December 2016